

**IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF VIRGINIA
HARRISONBURG DIVISION**

ATLANTIC COAST PRODUCE, INC.,)	
et al.)	
Plaintiffs)	Civil Action No. 5:04CV00015
)	
v.)	<u>MEMORANDUM OPINION</u>
)	
McDONALD FARMS, INC., et al.)	By: Samuel G. Wilson
Defendants.)	Chief United States District Judge

Plaintiffs, Atlantic Coast Produce, Inc., G. Cefalu & Brother, Inc., J.C. Banana & Co., Lambright Brokerage Company, Edward G. Rahll & Sons, Inc., Tony Vitrano Company, and W. Deemer Class & Son, move for a preliminary injunction under Rule 65 of the Federal Rules of Civil Procedure to prevent defendants, McDonald Farms, Inc. (“McDonald Farms”), Joan D. McDonald, James McDonald, Jr., Kimberly McDonald, and Sunrise, L.L.C. (“Sunrise”), from transferring any asset of Sunrise except for payment to the plaintiffs.¹ Plaintiffs claim they are the beneficiaries of a statutory trust pursuant to 5(c) of the Perishable Agricultural Commodities Act (“PACA”), 7 U.S.C. § 499e(c), and that defendants have commingled trust assets with Sunrise’s assets. In accordance with the following findings of fact and conclusions of law, the court grants plaintiffs’ motion.

I. FINDINGS OF FACT

¹In their proposed Findings of Facts and Conclusions of Law, plaintiffs also move this court to enjoin defendants from dissipating the assets of Kahn L.L.C. However, plaintiffs did not make this motion prior to the hearing before this court in which the parties argued the necessity of a preliminary injunction. Consequently, defendants were not adequately notified that an injunction against Kahn L.L.C. could result. Furthermore, the status of Kahn’s assets was not fully presented to this court during the hearing, and the court therefore believes it would be premature to grant an injunction as to Kahn. Consequently, the court will deny plaintiff’s motion for a preliminary injunction as to Kahn at this time without prejudice to reconsideration.

1. Plaintiffs are engaged in the business of buying and selling wholesale quantities of perishable agricultural commodities (“produce”) in interstate commerce, and at all times pertinent were licensed under PACA as dealers.

2. Defendant McDonald Farms was engaged in the business of buying wholesale quantities of produce in interstate commerce and was licensed under PACA as a dealer.

3. Between November 12, 2002, and February 13, 2004, plaintiffs sold to McDonald Farms wholesale amounts of produce worth \$475,680.77, which McDonald Farms accepted, but has not paid for as follows:

Atlantic Coast Produce, Inc.	\$44,584.50
G. Cefalu & Brother, Inc.	\$100,946.96
J.C. Banana & Co.	\$3,306.50
Lambright Brokerage Co.	\$1,024.75
Edward G. Rahl & Sons, Inc.	\$282,049.68
Tony Vitrano Company	\$4,151.69
W. Deemer Class & Son	\$39,616.69

4. Defendants Joan D. McDonald, James Kenneth McDonald, Jr., and Kimberly McDonald are the officers and directors of McDonald Farms. Joan D. McDonald is the sole shareholder of McDonald Farms.

5. McDonald Farms maintained two bank accounts at First Bank: the Wholesale Produce Account; and the Orchard Account. Joan D. McDonald, James Kenneth McDonald, Jr. and Kimberly McDonald were all signatories on the bank accounts maintained by McDonald Farms. Joan D. McDonald was primarily responsible for handling the accounts payable and accounts receivable of McDonald Farms.

6. Sunrise was formed in January, 1997, and is owned by Joan D. McDonald, the managing

member and majority owner, and Kimberly McDonald. Sunrise is a real estate holding company and owns the real property located at 2313 Middle Road, Winchester, Virginia 22601. Although this property is owned by Sunrise, it is the business address for McDonald Farms.

7. Defendants Joan D. McDonald and James Kenneth McDonald, Jr. own Kahn L.L.C (“Kahn”), which owns two parcels of real property in Winchester, Virginia: 1) 8.59 acres known as the Boyce Orchard; and 2) 148.95 acres known as the Wright Orchard.

8. Kahn operated the two orchards and usually deposited the sale proceeds from the orchard fruit in the McDonald Farms Orchard Account, although sometimes Kahn deposited the proceeds in the McDonald Farms Wholesale Produce Account.

9. Defendant Joan D. McDonald commingled the sales proceeds from McDonald Farms’ sale of wholesale produce with the sales proceeds from the fruit grown on the orchards owned and operated by Kahn, and she deposited the commingled proceeds into both of McDonald Farms’ bank accounts. The debts of McDonald Farms and Kahn were paid from either one of the bank accounts at the discretion of Joan D. McDonald.

10. Pursuant to a lease agreement dated January 1, 1998, McDonald Farms leased five parcels of land: 1) the Boyce Orchard owned by Kahn; 2) the Wright Orchard owned by Kahn; 3) 2313 Middle Road owned by Sunrise; 4) five acres owned by Kimberly McDonald; and 5) five acres owned by Joan D. McDonald. As rent for these properties, McDonald Farms paid all real estate taxes associated with the properties, tax return preparation costs for Sunrise and Kahn, and water and electric bills associated with the properties.

11. Sunrise has not maintained a bank account for over three years. McDonald Farms paid

any expenses incurred by Sunrise during this time.

12. McDonald Farms filed a voluntary Chapter 7 bankruptcy petition in the U.S. Bankruptcy Court for the Western District of Virginia on March 19, 2004. In re McDonald Farms, Inc., Case No. 04-00534-RWK-7.

13. On March 8, 2004, eleven days prior to the bankruptcy filing of McDonald Farms, Joan D. McDonald and Sunrise refinanced and consolidated three outstanding loans worth \$83,400.00. Sunrise replaced McDonald Farms as an obligor, and real property owned by Sunrise and Joan D. McDonald served as collateral for the refinanced loan.

14. Also on March 8, 2004, Joan D. McDonald and McDonald Farms entered into a loan modification agreement with Valley Farm Credit to modify a \$205,600 credit line taken out by McDonald Farms in March 2003. The agreement modified the original terms of repayment from monthly payments of principal and interest to interest only payments, and property owned by Sunrise served as collateral.

II. CONCLUSIONS OF LAW

1. A debt in the collective amount of \$475,680.77 is owed to plaintiffs for produce sold to McDonald Farms.

2. Congress enacted PACA to promote fair business practices in the marketing of perishable agricultural commodities. The stated purpose of the PACA is to remedy “a burden on commerce in perishable agricultural commodities [caused] by financing arrangements under which commission merchants, dealers, or brokers, who have not made payment for perishable agricultural commodities purchased, . . . encumber or give lenders a security interest in such commodities, or on inventories of

food or other products derived from such commodities, and any receivables or proceeds from the sale of such commodities or products . . .” 7 U.S.C. § 499e(c)(1).

3. In order for plaintiffs to assert rights under PACA as unpaid produce suppliers, they must give notice to McDonald Farms of their intent to preserve their rights. Under PACA, plaintiffs could give notice in two ways: via a written notice to McDonald Farms within thirty calendar days after payment was due, 7 U.S.C. § 499e(c)(3) (“notice method”); or via a printed statement on its regular invoices, 7 U.S.C. § 499e(c)(4) (“invoice method”). In this case, plaintiffs Atlantic Coast Produce, Inc., G. Cefalu & Brother, Inc., J.C. Banana & Co., Edward G. Rahll & Sons, Inc. Tony Vitrano Company, and W. Deemer Class & Son relied on the invoice method, and McDonald Farms received notice of these plaintiffs’ intent to preserve their PACA rights at the time of delivery. These plaintiffs printed the following statutorily required language on their invoices to McDonald Farms:

The perishable agricultural commodities listed on this invoice are sold subject to the statutory trust authorized by section 5(c) of the Perishable Agricultural Commodities Act, 1930 (7 U.S.C. § 499e(c)). The seller of these commodities retains a trust claim over these commodities, all inventories of food or other products derived from these commodities, and any receivables or proceeds from the sale of these commodities until full payment is received.

7 CFR § 46.46(f)(3)(i).

Plaintiff Lambright Brokerage Company relied on the notice method to preserve its trust benefits.

4. Under PACA, produce “received by a commission merchant, dealer, or broker in all transactions, and all inventories of food or other products derived from perishable agricultural commodities, and any receivables or proceeds from the sale of such commodities or products, shall be held by such commission merchant, dealer, or broker in trust for the benefit of all unpaid suppliers or

sellers of such commodities or agents involved in the transaction, until full payment of the sums owing in connection with such transactions has been received by such unpaid suppliers, sellers, or agents.” 7 U.S.C. § 499e(c)(2).

5. “Trust assets are to be preserved as a nonsegregated ‘floating’ trust. Commingling of trust assets is contemplated.” 7 C.F.R. § 46.46(b)

6. “Commission merchants, dealers, and brokers are required to maintain trust assets in a manner that such assets are freely available to satisfy outstanding obligations to sellers of perishable agricultural commodities. Any act or omission which is inconsistent with this responsibility, including dissipation of trust assets, is unlawful and in violation of section 2 of [PACA].” 7 C.F.R. § 46.46(d)(1).

7. Plaintiffs have preserved their rights under PACA and are the beneficiaries of the trust required to be maintained by defendants under 7 U.S.C. 499e(c) and the enabling regulations at 7 CFR 46.46 in the following unpaid, qualified amounts:

Atlantic Coast Produce, Inc.	\$44,584.50
G. Cefalu & Brother, Inc.	\$100,946.96
J.C. Banana & Co.	\$3,306.50
Lambright Brokerage Co.	\$1,024.75
Edward G. Rahl & Sons, Inc.	\$282,049.68
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8. As a result of the nonsegregated and “floating” nature of a PACA trust, produce sellers are not required to trace or otherwise demonstrate that their funds were used to obtain a particular asset. Instead, the produce buyer bears the burden of demonstrating that a disputed asset was not acquired with proceeds from the sale of particular produce, or from the sale of particular produce-related assets.

In re Kornblum & Co., Inc., 81 F.3d 280 (2nd Cir. 1996); Sanzone-Palmisano Co. v. M. Seaman Enterprises, Inc., 986 F.2d 1010 (6th Cir. 1993); Six L's Packing Co. v. West Des Moines State Bank, 967 F.2d 256 (8th Cir. 1992).

9. Although “it might be impossible to recover trust monies paid for an asset from a *bona fide* purchaser for value,” In re Al Nagelberg & Co., 84 B.R. 19, 21 (Bankr. S.D.N.Y. 1988), under general trust principles, the trust beneficiaries may recover trust assets if they are paid to someone other than a *bona fide* purchaser for value, see Am. Banana Co. v. Republic Nat'l Bank of N.Y., N.A., 362 F.3d 33 (2nd Cir. 2004); Reaves Brokerage Co. v. Sunbelt Fruit & Vegetable Co., 336 F.3d 410 (5th Cir. 2003), and the trust beneficiaries may recover any asset acquired by the trustee in exchange for trust assets. See In re Kornblum & Co., Inc., 81 F.3d 280 (2nd Cir. 1996); Tony Vitrano Co. v. National Produce Co., 815 F. Supp. 23 (D.D.C. 1996); In re Atlantic Tropical Marketing Corp., 118 B.R. 139 (Bankr. S.D. Fla. 1990).

10. “Well-established rules guide a district court's decision as to whether to issue an injunction. In reaching this decision, the district court must balance the hardships likely to befall the parties if the injunction is, or is not, granted. Blackwelder Furniture Co. v. Seileg Mfg. Co., 550 F.2d 189, 196 (4th Cir. 1977). Proper balancing of hardships requires the district court to weigh the relative importance of four factors: (1) the likelihood of irreparable harm to the plaintiff if the preliminary injunction is denied, (2) the likelihood of harm to the defendant if the requested relief is granted, (3) the likelihood that the plaintiff will succeed on the merits, and (4) the public interest.” Hoechst Diafoil Co. v. Nan Ya Plastics Corp., 174 F.3d 411, 416-17 (4th Cir. 1999) (citing Manning v. Hunt, 119 F.3d 254, 263 (4th Cir. 1997)).

11. Plaintiffs have established a likelihood of irreparable harm. Plaintiffs have demonstrated that they are owed \$475,680.77, that they are beneficiaries of a PACA trust, and that, absent the requested relief, trust assets will likely be dissipated, thereby making recovery difficult if not impossible. Tanimura & Antle, Inc. v. Packed Fresh Produce, Inc., 222 F.3d 132, 140 (3rd Cir. 2000); Continental Fruit Co. v. Gatziolis & Co., 774 F. Supp. 449, 453 (N.D. Ill. 1991); Gullo Produce Co. v. Jordan Produce Co., 751 F. Supp. 64, 67 (W.D. Pa. 1990).

12. By enjoining defendants from dissipating trust assets, defendants are only required to fulfill their statutory duties. The defendants, therefore, cannot show a likelihood of harm. Tanimura & Antle, Inc., 222 F.3d at 140.

13. Plaintiffs have shown a likelihood of success on the merits. Plaintiffs have presented substantial evidence that defendants diverted trust assets away from McDonald Farms' operations, used trust assets to maintain their real property and other business ventures, and commingled their assets with trust assets. Evidence of these actions include: McDonald Farms paying the real estate taxes and other expenses of Sunrise; using property owned by Sunrise as collateral for McDonald Farms' loans; commingling proceeds from produce sales and orchard sales; and paying Kahn's expenses from commingled accounts.

14. Defendants had actual notice that McDonald Farms' was violating its obligations as trustee by diverting trust assets, and they are accordingly not entitled to a *bona fide* purchaser defense.

15. The public interest is furthered by the granting of a preliminary injunction. PACA itself states that the trust was established to benefit the public interest, which had suffered due to nonpayment

for produce. 7 USCS § 499e(c)(1).

III.

For the reasons stated, the court grants the plaintiffs' motion for a preliminary injunction.

ENTER: This _____ of April, 2004.

Chief United States District Judge